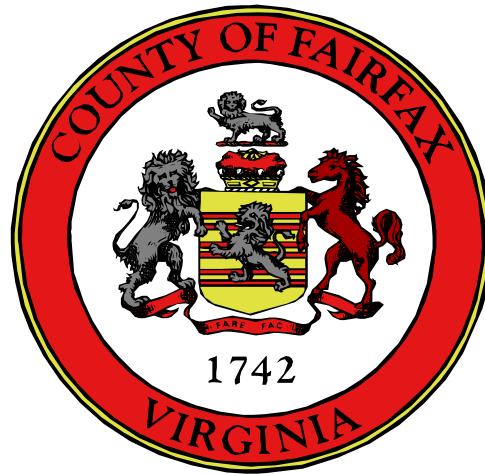


# **INTERNAL AUDIT REPORT**

## **Audit of the Financial Contract Process**



***Fairfax County Internal Audit Office***

**FAIRFAX COUNTY, VIRGINIA  
INTERNAL AUDIT OFFICE  
M E M O R A N D U M**

**TO:** Anthony H. Griffin  
County Executive

**DATE:** November 2, 2000

**FROM:** Ronald A. Coen, Director  
Internal Audit Office

**SUBJECT:** Report on the "*Financial Contract Process*"

This is a report on the "*Financial Contract Process*". It was performed as part of our FY 2000 Annual Audit Plan.

The findings and recommendations of this audit were discussed with the Department of Finance. We have reached agreement on all of the recommendations and I will follow up periodically until implementation is complete. Their responses are incorporated into the report and the full response is attached at the end of the report. After your review and approval, we will release the report to the Board of Supervisors.

RAC: dh

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## Introduction

Financial contracts have been utilized in Fairfax County since 1984 and are designed to be used for some of the more routine, recurring County expenditures. A Financial Contract is used in lieu of a purchase order to encumber funds and monitor expenditures for goods and services that do not require the additional control provided by the procurement process. A Financial Contract is well suited for recurring payments and can remain open for an entire fiscal year. Accounting Technical Bulletin (ATB) 017 *Financial Contract* is the financial and accounting policy that County departments follow in processing financial contract transactions. Financial Contracts are established in the Financial Accounting & Management Information Management System (FAMIS) as an encumbrance document and payments are made through FAMIS as encumbrance payments. The Department of Finance (DOF), Accounts Payable Section, reviews all voucher transactions \$5,000 and above to ensure they have been properly completed by the initiating department and authorizes final posting to the County's Financial Accounting & Management Information System. Financial Contracts were used to expend approximately \$184 million in fiscal year 2000.

DOF decentralized the final authorization of Financial Contract vouchers under \$5000 to individual departments in November 1997. Since 1997 there has been a significant increase in Financial Contracts. The reasons for the increase vary from more wide spread knowledge by the departments and using financial contracts to pay capital construction contract vendors.

## Purpose and Scope

This audit was performed as part of our FY 2000 long-range Audit Plan. Our audit objectives were to determine that:

- Financial contracts are being processed in accordance with regulations and County policy;
- Financial Contract vouchers are based upon a recognized liability, accurately prepared, recorded, reviewed and authorized;
- Proper internal controls and separation of duties are in place and being followed.

We selected samples from six County departments to evaluate their compliance with DOF guidelines (ATB 017- *Financial Contract*) and Department of Finance Notice (DFN) 020-1- *Account Payable Internal Controls*). We selected the following departments with medium and large operations:

- Department of Finance
- Department of Waste Management
- Department of Information Technology
- System Engineering & Monitoring Division
- Department of Housing & Community Development
- Department of Management & Budget (Contributory Departments)

We also determined if DOF rules and regulations provide reasonable assurance that financial contract

vouchers are used to make payments to vendor categories that are specifically identified in ATB 017.

The audit period covered July 1999 through March 2000. The benefits of this audit include stronger controls, improved performance, and to inform management on departmental compliance to financial contract policies.

## Methodology

We reviewed and analyzed internal control procedures, separation of duties, transaction input and authorization. We also reviewed monitoring of encumbrances and the associated payments. Our review included interviewing appropriate County employees, examinations of financial contract voucher payments, reports, and DOF policies and procedures. We also tested to determine if the user department had obtained the necessary approval from DPSM prior to entering into a financial contract. The audit was conducted in accordance with generally accepted government auditing standards.

## Executive Summary

In our opinion, from our review of the Financial Contract process at six County departments, we found that the principles of internal controls, separation of duties, reviewing, and authorization of financial transactions are adequate and operating effectively.

The following opportunities for enhancements to controls and limiting County liability are discussed in detail in the report.

- Two FAMIS transaction codes allow users to encumber funds that exceed authorized amounts. This could result in an unfunded liability being created. This allows a user to create a liability when sufficient funds are not available to liquidate the liability. While the scope of our audit only included three transaction codes, it is possible that this condition may extend to other FAMIS transaction codes. Our testing did not determine that departments were in fact encumbering funds that exceeded authorized levels, however the capability and inherent weakness in the system still exist. We recommend DOF change the Appropriation Edit Control in the transaction edit field to prevent users from encumbering more funds than available.
- We were unable to audit for compliance of financial contract vouchers to County policy. Department of Finance (DOF) has one County policy addressing the processing of financial contract voucher payments (Accounting Technical Bulletin (ATB) 017, issued in January 1996). Financial contracts are being used to make payments to vendors (contributories, insurance administrators and capital contracts) that do not conform to the categories of allowable expenditures identified in ATB 017. However, it should be noted that based on our sample testing we did not find any instances of improper purchases being made. We recommend DOF make revisions to this ATB that properly reflect the appropriate expenditure categories that are currently being used by County departments.
- DOF's procedures for verification of information on the financial contracts in FAMIS are not written and must be communicated orally. Oral instructions are subject to misinterpretation and not always understood. The verification procedures performed by DOF's accounts payable personnel should be explained in detail and documented in the accounts payable procedure manual.

During our examination of six departments selected for their compliance to the DOF guidelines, minor deficiencies in internal controls, voucher processing steps, and the absence or outdated internal procedures were discussed and resolved with the departments.

## Comments and Recommendations

### **1. FAMIS Transaction Codes 095 and 870 do not provide proper funds control and allow the user to encumber funds that exceed authorized funds available.**

This is contrary to prudent Government Accounting Standards relating to funds control. This allows a user to potentially create a liability when sufficient funds are not available to liquidate the liability. Our testing did not determine that departments were in fact encumbering funds that exceeded authorized levels, however the capability and inherent weakness exists in the system. While the scope of our audit only included three transaction codes (076, 095, and 870), it is possible that this weakness extends further to other FAMIS transaction codes as well.

We could not identify a cause for the weakness, other than poorly defined transaction codes. We found the Department of Housing & Community Development (DHCD) has the ability to encumber more funds than authorized. This may have been utilized at DHCD to encumber funds for a construction housing project when the funds had not yet been received from Housing and Urban Development (HUD).

#### **Recommendation**

DOF should change the Appropriation Edit Control in the transaction edit field in order to prevent Transaction Codes 095 and 870 from being able to encumber more funds than available. In our discussions with KPMG – Peat Marwick’s technical staff we were advised that this change could be made without impacting other controls or Transaction Codes in the system.

#### **Department Response**

As recommended by the Internal Audit Office, the funds control on these transactions was changed. This change was made on September 28, 2000.

### **2. The Department of Finance (DOF) Accounting Technical Bulletin (ATB) 017 serves as guidance for County Departments in processing financial contract payments. However, the ATB is outdated and should be revised to include the appropriate expenditure categories that are currently being used.**

DOF’s Accounting Technical Bulletin (ATB) is the County policy for processing financial contract payments. The ATB has not been updated since January 1996 to reflect current operations or expenditure categories where financial contracts are appropriate to use for payment purposes.

Financial Contract documentation provides departments with County policy guidelines for processing periodic vendor payments. Documentation should be current in order to provide up-to-date information to County departments.

With the implementation of CASPS and FAMIS 4.2 systems, many of the ATB’s currently in use are outdated and not in conformance with these systems. DOF is reviewing all ATBs for needed updates, however, due to the volume of ATBs, the review will take some time to complete. In the meantime, Department of Finance Notices (DFN’s) are being prepared as policy to the departments to use.

#### **Recommendation**

We recommend that DOF prioritize the updating of all ATB's. ATBs should be prioritized according to the impact on the financial process. ATB 017 (financial contracts) is one of the financial processes that needs to be scheduled for updating. DOF and DPSM management and staff that are involved in the financial contract process should jointly review ATB 017. Revisions should be a coordinated effort on what changes are needed. Changes should be passed to the DOF Policy Coordinator who would communicate any changes to County Departments.

### **Department Response**

The Department of Finance has established a team to facilitate the update of all ATBs and work has begun. The Department anticipates the project will take two years to complete. Our plan includes consultation with the affected agencies so that we prioritize this effort correctly and include relevant subject matter that might now be missing. To date, the team has used the Group Decision Support Center (GDSC) to evaluate the ATB format to enhance readability and has updated a draft of ATB 020, Reconciliation, one of the most critical ATB's, using this new format.

### **3. Specific procedures followed for the processing, verification and payment of Financial Contracts are obsolete, need to be updated and be more specific. Additionally, procedures are not written and included in the Accounts Payable procedure manual.**

To be certain procedures are not forgotten or misunderstood, the verification procedures performed by DOF's accounts payable clerks should be written and included in DOF's policy and procedures manual. This could be used as a reference for all current clerks and a good training vehicle for newly hired clerks. Standard internal controls provide that policies and procedures should always be written and included in the policy and procedures manual. By not having written procedures to follow regarding the verification of selected fields prior to payment, accounts payable clerks could forget to perform the proper procedures or perform the wrong procedures.

According to discussions with DOF management we were advised that policies included in ATB 017 were being followed. However, upon review ATB 017 does not specifically identify the payment verification procedures to be followed prior to approving payment.

### **Recommendation**

We recommend that DOF develop written policies and procedures that identify the specific fields to be verified by DOF and other procedures to be performed prior to approving financial contract payments and including the same in the policy and procedures manual. Procedures should be given to each accounts payable clerk so that they could have a copy for necessary reference.

### **Department Response**

Step by step procedures will be written to guide clerks in the audit of financial contract payment requests. This documentation will be done in conjunction with the ATB revisions outlined in the response to finding #2.